



Local Finance and Fiscal Equalization Schemes in a Comparative Perspective: Australia and Canada

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Introduction

- ❑ Horizontal fiscal imbalance – some municipalities are unable to provide an adequate level of services at reasonable tax rates
- ❑ Why?
 - ❑ costs may be higher
 - ❑ needs may be greater
 - ❑ tax base may be smaller
- ❑ State/local equalization grants allow municipalities with small tax base and high needs/costs to provide a comparable level of service at comparable tax rates

Outline of Presentation

- ❑ Background on local government
 - ❑ Australia
 - ❑ Canada
 - ❑ Germany
- ❑ State-local equalization in Australia
 - ❑ State of Victoria
- ❑ Provincial-local equalization in Canada
 - ❑ Province of Nova Scotia
 - ❑ Province of Ontario
- ❑ Implications for German local governments

Background on Local Government

Table 1: Expenditures per Capita and Local Taxes in Three Countries, 2011
(Euros)

	Germany	Australia	Canada
Local government	2,523	1,011	3,151*
State government	4,160	6,831	8,650
Central government	9,613	12,625	6,890
Local taxes as % of total taxes	13.0	3.5	11.8

*Includes school boards and Aboriginal governments

Source: Calculated from IMF, Government Finance Statistics Yearbook, 2012

Background on Local Government

Distribution of Local Government Revenues, 2011 (%)

	Germany	Australia	Canada
Taxes	37.9	37.0	36.4
Taxes on income, profits and capital gains	30.3	0.0	0.0
- Individuals	14.5	0.0	0.0
- Corporations	15.8	0.0	0.0
Taxes on payroll and workforce	0.0	0.0	0.0
Taxes on property	5.1	37.0	35.5
Taxes on goods and services	2.5	0.0	0.9
Other taxes	0.0	0.0	0.0
Grants	35.5	16.8	47.1
Other revenue	26.6	46.2	16.6
Total revenue	100.0	100.0	100.0

Source: Calculated from IMF, Government Finance Statistics Yearbook, 2012

State-Local Equalization in Australia

- ❑ Central funding to state governments to local governments
- ❑ Local Grants Commissions
- ❑ General purpose grants plus local roads grants (all unconditional)
- ❑ National principles for allocation e.g. horizontal equalization; effort neutrality; minimum grant

State-Local Equalization in Australia

- ❑ Detailed expenditure need weighted by indicators that reflect differences in local conditions beyond the control of local government (“disabilities “or “cost adjustors”):
 - ❑ need differences – e.g. age, income levels
 - ❑ cost differences -- e.g. economies of scale, population density
- ❑ Standard expenditure = population X average state expenditure per capita X disability factor

State-Local Equalization in Australia

- ❑ Revenue needs defined as revenues a council would raise if standardized revenue effort (tax rate) were applied to revenue base
- ❑ Revenue capacity = standard tax rate X assessment base (averaged over 3 years)
- ❑ Some states also include user charges in revenue capacity

State of Victoria

- ❑ 9 expenditure categories
- ❑ 14 disabilities /cost factors
- ❑ Revenue capacity includes property taxes, payments in lieu of taxes, user fees and charges
- ❑ 5 revenue adjustors

Australian Equalization: Observations

- ❑ Complexity with disability factors – but still subjective
- ❑ Lack of transparency
- ❑ Excludes capital expenditures
- ❑ Property tax – different assessment methods; other features not included in measure
- ❑ Does it reduce efficiency?

Canada – Nova Scotia

- ❑ Formula based on expenditure need and revenue raising ability
- ❑ Equalization within each of two classes of municipalities -- regional municipalities and towns versus counties and districts
- ❑ Compare “standard” expenditure and “standard” revenue
- ❑ Selected expenditures only – police, fire, roads, and some environmental
- ❑ Tax base –assessed value (not weighted to reflect tax differentials)

Nova Scotia - Observations

- ❑ Less than half of municipal expenditures included – incentive to use creative accounting
- ❑ Unweighted assessment does not reflect greater ability to raise revenues from commercial/industrial property
- ❑ Does not include revenues other than property tax
- ❑ Municipality cannot receive fewer grants than previous year – dilutes equalization impact

Canada: Ontario

- ❑ Context of provincial uploading; grant reduction
- ❑ Assessment equalization grant
- ❑ Northern and rural fiscal circumstances grant
 - ❑ support to municipalities with limited tax base
 - ❑ target funding to those with more challenging fiscal circumstances
 - ❑ transitional assistance so northern municipalities receive at least 95% of previous year's allocation; others at least 85%; with more challenging circumstances – 100%

Canada: Ontario

- ❑ Primary indicators (50%) – weighted assessment per household and median per household income
- ❑ Secondary indicators (50%) – average annual change in assessment, employment rate, ratio of working age to dependent population, % of population below low-income threshold
- ❑ Municipal fiscal circumstances indicator (MFCI):
 - ❑ each indicator is scored relative to median
 - ❑ average indicator score of all indicators (weighted)
 - ❑ index measured on a scale from 0 to 10 (ranked municipalities)

Ontario - Observations

- ❑ Small number of exogenous variables
- ❑ Captures expenditure need and revenue raising ability
- ❑ Excludes state of the infrastructure as part of fiscal circumstances
- ❑ Only available to northern and rural municipalities

Implications for German Local Governments

- Different context – local property tax versus income tax
- Formula-based transfers – are they simple and transparent?
- Local Grants Commissions – are they needed?
- Differentiating among municipalities – does size matter?
- Expenditure need and revenue capacity – how to measure?
- Fiscal effort – should it be included?
- Incentive effects – what are they?
- Insurance against shocks – is there a moral hazard problem?